Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

FLOYD E. RILEY,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

Petition for Writ of Certiorari to the
United States Court of Appeals for the Eighth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether an act in violation of 11 U.S.C. § 362 and all actions subsequent thereto are void or voidable.

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PETITION FOR WRIT OF CERTIORARI

Petitioner Floyd E. Riley respectfully requests that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit entered in this action on July 7, 1997 reversing the final judgment of the United States District Court for the Eastern District of Missouri.

OPINIONS BELOW

On October 25, 1995, the United States District Court for the Eastern District of Missouri held that the notice of proposed assessment issued by the Internal Revenue Service during Petitioner's bankruptcy case violated the automatic stay, 11 U.S.C. § 362, and, thus, the subsequent assessment was void. The decision is reported at 192 B.R. 727 (E.D.Mo. 1995). The United States Court of Appeals for the Eighth Circuit reversed this decision and remanded for further proceedings. This decision is reported at 118 F.3d 1220 (8th Cir. 1997). Without discussion, the Eighth Circuit denied Petitioner's suggestion for rehearing *en banc*. The decisions are reprinted in Appendices A-1 and A-7, *infra*.

STATEMENT OF JURISDICTION

The judgment of the Court of Appeals for the Eighth Circuit was entered on July 7, 1997. Jurisdiction is conferred on this Court by 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

11 U.S.C. § 362

STATEMENT OF THE CASE

In 1991, Ferco Fabricators, Inc. ("Ferco") was bankrupt and filed for relief under Chapter 7 of the United States Bankruptcy Code, 11 U.S.C. 701 *et seq.*[1] Although Respondent Internal Revenue Service ("IRS") held a priority position in the bankruptcy case, the IRS failed to take any action to liquidate Ferco's assets that would have satisfied the $683,675.24 owed for withholding taxes.

Shortly thereafter, Petitioner Floyd E. Riley ("Riley") also filed Chapter 7. While his case was still pending, the IRS issued Riley a Notice of Proposed Assessment (the "Notice") pursuant to 26 U.S.C. § 6672 demanding a 100 percent penalty for *Ferco's* failure to pay these same withholding taxes.

The Notice allowed Riley 30 days to pay $683,675.24 or appeal the Notice to the IRS. Still bankrupt, Riley appealed. Taking longer than one year and even beyond the end of Riley's bankruptcy case, the IRS eventually denied Riley's appeal and assessed the proposed amount. Pursuant to statute, Riley paid the IRS $2,000.00 and commenced a refund and abatement action in the United States District Court for the Eastern District of Missouri; jurisdiction was conferred under 28 U.S.C. §§ 1331 and 1346(a)(1). The IRS counterclaimed for the remainder of the penalty.

The district court granted Riley's motion for summary judgment holding that as a matter of law the Notice was issued during Riley's bankruptcy case in violation of 11 U.S.C. § 362 (the "Automatic Stay") and was void. A-5. The district court further held that even if the IRS was not required to issue the Notice prior

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[1] All references to the United States Bankruptcy Code (the "Bankruptcy Code") are to 11 U.S.C. *et seq.*, 1988 edition, unless specifically noted. The 1994 Amendments to the Bankruptcy Code are not retroactive with respect to the provisions discussed herein.

to assessment, it was undisputed that the IRS, in fact, did so which forced Riley to defend himself in an administrative appeal that resulted in assessment. A-5. Therefore, the assessment was void *ab initio*. The district court decision is reported at *Riley v. United States*, 192 B.R. 727 (E.D.Mo. 1995).

The IRS appealed to the United States Court of Appeals for the Eighth Circuit. The Eighth Circuit reversed the district court holding that although the IRS knowingly violated the Automatic Stay by issuing the Notice, the resulting assessment occurred after Riley was discharged from bankruptcy and, thus, was not void and was an otherwise irrelevant defense to a refund action. A-9, A-10. This decision is reported at 118 F.3d 1220 (8th Cir. 1997).

Riley now timely files this Petition for Writ of Certiorari with this Court.

REASONS FOR GRANTING THE WRIT

THE EIGHTH CIRCUIT'S HOLDING CONFLICTS WITH DECISIONS OF OTHER UNITED STATES CIRCUIT COURTS OF APPEAL AND IS CONTRARY TO AN EXISTING DECISION OF THE UNITED STATES SUPREME COURT AND THE LANGUAGE AND INTENT OF THE UNITED STATES BANKRUPTCY CODE.

I. The Eighth Circuit's Decision is Inconsistent with a Majority of Circuit Courts Which Have Held that Violations of the Automatic Stay are Void *Ab Initio*.

Although the IRS is one of the largest and most sophisticated creditors, the Eighth Circuit in this case has dismantled one of the few protections available to keep this governmental Goliath and other creditors at bay. There is no dispute that the IRS violated the Automatic Stay when it issued Riley the Notice. However, the Eighth Circuit held that whether this act and those subsequent thereto are void or voidable is a theoretical distinction and otherwise irrelevant to a refund action. A-9, A-10. This decision cannot be reconciled with the holdings of a majority of the circuit courts declaring such acts void *ab initio*. *In re Soares*, 107 F.3d 969 (1st Cir. 1997); *Constitution Bank v. Tubbs*, 68 F.3d 685 (3d Cir. 1995); *Franklin v. Office of Thrift Supervision*, 31 F.3d 1020 (10th Cir. 1994); *Rexnord Holdings, Inc. v. Bidermann*, 21 F.3d 522 (2d Cir. 1994); *In re Schwartz*, 954 F.2d 569, 572 (9th Cir. 1992); *In re Albany Partners*, 749 F.2d 670, 675 (11th Cir. 1984); *Matthews v. Rosene*, 739 F.2d 249, 251 (7th Cir. 1984). Even this Court has held (under a predecessor to the Automatic Stay) that creditors must not benefit from their unlawful acts and, thus, they are void and subject to collateral attack. *E.g., Kalb v. Feurstein*, 308 U.S. 433, 443, 60 S.Ct. 343, 348, 84 L.Ed. 370 (1940)(sheriff's sale during bankruptcy void and all subsequent actions taken also void).

Concluding that acts in violation of the Automatic Stay are void, a majority of circuit courts have each recognized and emphasized the sweeping language, the self-executing nature of the Automatic Stay and the essential function it serves in the administration of the bankruptcy estate. The Automatic Stay does not extinguish or discharge any debts. *Pennsylvania Public Welfare Dept. v. Davenport*, 495 U.S. 552, 560 n.3, 110 S.Ct. 2126, 109 L.Ed.2d 558 (1990). It merely grants the debtor a brief respite from creditors' claims and attempts to preserve the status quo so that assets may be collected and reorganized or liquidated in an orderly manner. H.R.Rep. 595, 95th Cong., 1st Sess. 340 (1978), *reprinted in* 1978 U.S.Code Cong. & Admin. News 5963, 6296-97. This benefits not only debtors by providing them a breathing spell but also creditors by allowing the courts and trustees time and ability to gather the property of the estate for their collective benefit. *See* S.Rep. 95-989, 95th Cong., 2d Session 54 (1978), *reprinted in* 1978 U.S.Code Cong. & Admin.News, pp. 5787, 5849. This function is defeated if a single creditor is allowed to violate the Automatic Stay pillaging a debtor's assets in order to collect a debt or forcing the debtor to spend time and resources to defend himself as Riley was forced to do in this case.

It is this attempt to circumvent and undermine the bankruptcy process itself that has drawn the greatest fire from the circuit courts. As thoroughly explained by the Ninth Circuit in *In re Schwartz*, the debtor is trying to regain his financial footing and should not face the additional hardship of fending off creditors who violate the Automatic Stay. *Schwartz*, 954 F.2d at 571-72. The debtor in *Schwartz* challenged an assessment by the IRS for withholding tax penalties asserting that it violated the Automatic Stay and was void *ab initio*. *Id.* at 575. The Ninth Circuit agreed warning that if the unlawful acts are not unmistakably void, creditors will be encouraged to violate the Automatic Stay and risk a potential challenge by a weakened debtor.

> If violations of the stay are merely voidable, debtors must spend a considerable amount of time and money policing and litigating creditor actions. If violations are void, however, debtors are afforded better protection and can focus their attention on reorganization.
>
> * * *
>
> Nothing in the Code or legislative history suggests that Congress intended to burden a bankruptcy debtor with an obligation to fight off unlawful claims. The position championed by the IRS in this case [that a § 6672 assessment in bankruptcy is not void] would impose severe hardships on debtors trying to regain their financial footing.

Id. at 571-72.

The Eighth Circuit circumvented the void/voidable dilemma declaring that the Automatic Stay, which Riley asserted as a complete defense to the IRS's claims, was irrelevant to a refund action and merely a theoretical distinction that it refused to address. A-9, A-10. It rejected the district court's adoption of *Schwartz* declaring the IRS's acts void and, in effect, shifted the burden far beyond that of any other circuit court creating a presumption of validity in favor of the creditor. Under this unprecedented interpretation, the efficacy of the Automatic Stay in the Eighth Circuit is now in doubt.

The purpose of the Automatic Stay was not to allow creditors to test the waters to determine whether an act violates the stay. The idea was to create a menacing figure, actually feared by creditors, that stopped creditors at the water's edge. "[C]ourts must display a certain rigor in reacting to violations of the automatic stay." *Soares*, 107 F.3d at 975-976. By voiding such acts and attaching fees and even punitive damages, the Automatic Stay puts creditors on notice that if they violate it, they risk losing even more than they sought. This was the intent of

Congress and the foundation of the majority view, a view that cannot be reconciled with the approach taken by the Eighth Circuit in this cause.

II. The Eighth Circuit's Decision is Also Inconsistent with the Minority of Circuit Courts Which Have Held that Violations of the Automatic Stay Are Voidable.

The approach of the Eighth Circuit is far from consonant with even the minority of circuit courts holding that actions in violation of the Automatic Stay are voidable. *Bronson v. United States*, 46 F.3d 1573 (Fed.Cir. 1995); *Easley v. Pettibone Michigan Corp.*, 990 F.2d 905, 909-11 (6th Cir. 1993); *Picco v. Global Marine Drilling Co.*, 900 F.2d 846 (5th Cir. 1990).[2] Instead of looking to the language and purpose of the Automatic Stay, the minority view has contrasted it with other provisions of § 362 and the Bankruptcy Code finding several sections inoperable or rendered moot if actions violating the Automatic Stay are void.

The Sixth Circuit in *Easley v. Pettibone Michigan Corp.* looked first to the Bankruptcy Court's power to "annul" the Automatic Stay pursuant to § 362(d). "This power to annul 'permits the order to operate retroactively, thus validating actions taken by a party at a time when he was unaware of the stay.'" *Easley*, 990 F.2d at 910, *quoting* 2 *Collier on Bankruptcy* § 362.07. The circuit court thus concluded that in order to harmonize the language of the Automatic Stay with the power to annul, actions in violation of the Automatic Stay must be characterized as "invalid and voidable, since void actions are incapable of later cure or validation." *Easley*, 990 F.2d at 910. The Sixth Circuit similarly noted that where several circuits (including those in the majority) have used their equitable

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[2] The position of the Sixth Circuit is unclear with two panels holding violations void and another holding them voidable. *Compare Easley*, *supra*; *In re Smith*, 876 F.2d 524 (6th Cir. 1989)(void); *National Labor Relations Board v. Edward Cooper Painting, Inc.*, 804 F.2d 934 (6th Cir. 1986)(void).

powers (presumably under 11 U.S.C. § 105) to forestall the operation of the Automatic Stay, "these circuits are really viewing actions taken in violation of the stay as voidable." 990 F.2d at 910, *citing In re Calder*, 907 F.2d 953 (10th Cir. 1990); *Matthews*, 739 F.2d 249; *In re Smith Corset Shops*, 696 F.2d 971 (1st Cir. 1982).

The Sixth Circuit further rejected the majority view that the power to annul under § 362(d) operates as a narrow exception to the broad general rule (in subsection (a)) that acts in violation of the stay are void. *Easley*, 990 F.2d at 910; *see Schwartz*, 954 F.2d at 573 (absent affirmative relief from the court, violations of the Automatic Stay are void). The Sixth Circuit explained that such characterization should manifest at the time of the violation and not later if and when a creditor obtains relief under § 362(d). This merely creates an unnecessary legal fiction. *Id.* Instead, because the power to annul the Automatic Stay under § 362(d) allows the court to validate a previously invalid act, the Sixth Circuit concluded that, by definition, the act must be voidable. 990 F.2d at 919-910.

Finally, circuits in the minority raise a more troubling conflict between a void act under the Automatic Stay and the operation of 11 U.S.C. § 549. *See, e.g., Sikes v. Global Marine, Inc.*, 881 F.2d 176, 179 (5th Cir. 1989). Under § 549, the bankruptcy trustee may avoid certain authorized transfers[3] and all unauthorized transfers of estate property regardless of the Automatic Stay. *Id.* Because the definition of transfer is so broad, the minority view posits that the Automatic Stay and § 549 can apply to the same transactions. *Id.* However, § 549 implies that such transfers are valid unless challenged by the trustee. Therefore, violations under the Automatic Stay cannot be declared void for

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[3] "Transfer" is "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property. . . ." 11 U.S.C. § 101(50).

§ 549 would effectively be rendered moot. *Id.* Unable to reconcile these competing sections of the Bankruptcy Code, the minority of circuit courts have concluded that because violations of the Automatic Stay can be annulled or avoided, such acts must be characterized as voidable.

In each of the aforementioned examples, the decision of the circuit court hinged upon a creditor's ability to seek retroactive relief through sections other than the Automatic Stay. The Eighth Circuit, however, refused to address this issue and, in effect, annulled the Automatic Stay and ratified the IRS's actions without any statutory authority creating further confusion among the courts of this and other circuits.

CONCLUSION

The Automatic Stay is the cornerstone of the Bankruptcy Code. Without it, creditors, like vultures, will devour what assets exist in a frenzy leaving bankruptcy courts with nothing to distribute but mere crumbs and little real power to stop the violators. Priorities will mean nothing. Instead, the largest, most sophisticated creditors like the IRS will hover over debtors and take all within their grasp. By overlooking this split of opinion on such an important issue, the Eighth Circuit inadvertently created yet a third view unprecedented in bankruptcy law jurisprudence. By refusing to punish the IRS for its flagrant violation of the Automatic Stay, the Eighth Circuit opened the gate for other creditors to trample upon the rights of debtors leaving the efficacy of the Code uncertain. Therefore, Riley respectfully requests this Supreme Court to grant his Petition for Writ of Certiorari in order to resolve this important question of federal law.

Respectfully submitted,

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